

COPY

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE COMMISSION,
ON ITS OWN MOTION, SEEKING TO
DETERMINE ACCESS COSTS FOR
U S WEST (N/K/A QWEST
CORPORATION

APPLICATION NO. NUSF-17

REBUTTAL TESTIMONY OF

SCOTT A. MCINTYRE

DIRECTOR – PRODUCT AND MARKET ISSUES

QWEST CORPORATION

July 12, 2002

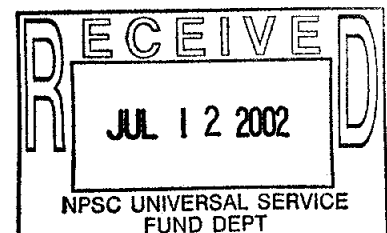


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I. INTRODUCTION OF WITNESS

Q. PLEASE STATE YOUR NAME, TITLE AND ADDRESS.

A. My name is Scott A. McIntyre. I am employed by Qwest Corporation (Qwest) as Director – Product and Market Issues. My business address is Room 3009, 1600 7th Avenue, Seattle, WA, 98191.

Q. ARE YOU THE SAME SCOTT A. MCINTYRE WHO FILED DIRECT TESTIMONY IN THIS DOCKET?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this rebuttal testimony is to respond to the testimony filed by Sue Vanicek on behalf of the rural independent telephone companies.

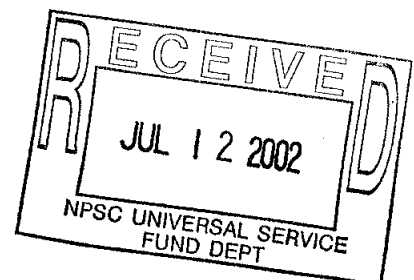
III. REBUTTAL

Q. WHAT ASPECTS OF MS. VANICEK'S TESTIMONY DO YOU WISH TO ADDRESS?

A. Her claim is that since there is no proof that implicit subsidies exist within Qwest's intrastate switched access rates, no switched access rate reductions are warranted.

Q. DOES MS. VANICEK PROPOSE A WAY OF PROVING THAT IMPLICIT SUBSIDIES EXIST IN QWEST'S CURRENT SWITCHED ACCESS RATES?

A. Yes. She states that a stand-alone cost study is necessary to determine if switched access is providing subsidy funds.



Q. WITH WHAT ASPECT OF HER TESTIMONY DO YOU DISAGREE?

A. I do not agree that a stand-alone cost study is necessary in the case presented here. I believe the Commission can still determine that switched access reductions are reasonable in light of the public policy implications.

Q. WHY IS A STAND-ALONE COST STUDY FOR SWITCHED ACCESS NOT REQUIRED IN THIS CASE?

A. Stand-alone cost studies certainly can prove the existence of implicit subsidies as Ms. Vanicek contests, but only under certain circumstances and only to a certain degree. There are situations where stand-alone cost studies, by themselves, prove nothing at all.

Q. PLEASE PROVIDE SOME EXAMPLES OF HOW STAND-ALONE COST STUDIES ARE IRRELEVANT TO POLICY MATTERS SUCH AS THIS.

A. First and foremost, in order for a subsidy to exist at all, there must be some service that is being offered below its incremental cost to provide. If no service is offered below incremental cost, then no subsidy exists, even if other services are offered at prices above their stand-alone cost. In this situation, stand-alone cost studies are irrelevant to any pricing discussion. Revenues collected above and beyond the stand-alone cost of production merely represent contribution to the running of the business. They are not a subsidy at all.

In another situation, there may be services offered below incremental cost, but no service is offered above its stand-alone cost. In this case, there is clearly a subsidy in existence, but a stand-alone cost study will not identify the source of subsidy support.

In yet another situation, one service may be priced below its incremental cost, and another priced above its stand-alone cost, yet the service priced above its stand-alone cost is not the only source of subsidy support. Other services, priced below their stand-alone cost may also be providing subsidy support.

Q. CAN YOU PROVIDE MORE DETAIL AS TO HOW THIS WORKS?

A. Yes. Suppose a company offers ten different products. For the first example, above, assume that none of the products is offered below its incremental cost. Also assume that one of the products is offered above its stand-alone cost. In such a situation, the fact that one product is offered above its stand-alone cost, proves nothing at all. This fact is irrelevant because no product is being subsidized at all.

For the second example, assume that one product of the ten is offered below its incremental cost but no service is offered above its stand-alone cost. The recipient of subsidy support in this case is clear, but the source cannot be determined by a stand-alone cost study. In this case subsidy support is largely a matter of pricing policy rather than economic arithmetic. Also note that in this case, a stand-alone cost study is required for all ten products.

For the third situation, suppose that one service is offered below its incremental cost and the total shortfall amounts to an annual total of \$3 million. Next, suppose that one other product is being offered at a price above its stand-alone cost and the excess revenue provided by this product is \$1 million. By excess, I mean revenue produced in excess of the total stand-alone cost of the service. This means that while it is clear that one product is receiving subsidy support and another is producing subsidy support, the picture is incomplete. Other services must be producing subsidy support as well, even though they are priced below their stand-alone costs. In fact, it is possible that one or more of the other services is contributing in total, even more than the service priced above its stand-alone cost.

Q. IS THERE EVER A CASE WHERE A STAND-ALONE COST STUDY WILL CLEARLY IDENTIFY THE SOURCE OF SUBSIDY SUPPORT FOR OTHER SERVICES?

A. Yes, but it is a very limited scenario. First, there must be one or more services priced below its incremental cost. Next, the service priced above its stand-alone cost must produce total excess revenues that are equal to or greater than the shortfall created by the service offered below cost. In addition however, there must be a stand-alone cost study

provided for each and every service offered by the company, or at least a substantial number of services. If a certain service is the only service offered above its stand-alone cost and the total excess revenue produced by that service is equal to or greater than the shortfall of the other product, then it will be generally accepted that the product offered above stand-alone cost is clearly subsidizing the other. In absence of any of these conditions, such a clear conclusion cannot be reached.

Q. WHY IS IT NECESSARY TO PERFORM STAND-ALONE COST STUDIES ON ALL SERVICES?

A. Because there might be more than one service offered above its stand-alone cost. In such a case, the source of subsidy support is once again obscure. For example, suppose one product is offered below its incremental cost and the total shortfall is \$3 million in annual revenues. Also suppose that two products are found to be priced above their stand-alone costs and one produces excess revenues (above stand-alone cost) in the annual amount of \$1 million, while the other product priced above its stand alone cost produces excess revenues in the annual amount of \$3 million. In this case, it is unclear as to how much subsidy support is being provided by each product.

Q. ARE THERE WAYS TO CALCULATE SUBSIDIES, GIVEN MULTIPLE POSSIBLE PRODUCTS THAT CONTRIBUTE?

A. Yes. There are some formulas that have been derived involving multiple products, but again, this situation does not require such analysis.

Q. IF NO SERVICE IS PRICED ABOVE ITS STAND-ALONE COST, DOES THIS MEAN THAT NO SUBSIDIES CAN EXIST?

A. No. As I explained above, stand-alone cost analysis only provides limited information in limited circumstances. Subsidies can still exist even if all services are priced below stand-alone cost, as long as some service or services are priced below their incremental cost.

Q. DOES QWEST AGREE WITH MS. VANICEK THAT IT IS “UNLIKELY THAT THE CURRENT ACCESS RATES ARE PRODUCING REVENUES IN EXCESS OF THE STAND-ALONE COST OF PRODUCING ACCESS SERVICE”?¹

A. Qwest takes no position on whether current switched access rates are above or below stand-alone costs. Stand-alone cost studies are an interesting concept, but due to the fact that they offer only insight under most real world circumstances, Qwest has not performed such studies and does not plan to in the future.

Q. IN YOUR PERSONAL OPINION, WHAT IS THE LIKELY OUTCOME OF PERFORMING STAND-ALONE COST STUDIES ON ALL OF THE SERVICE OFFERED BY QWEST?

A. I would expect that no services would be priced above their stand-alone costs.

Q. ON WHAT DO YOU BASE THIS OPINION?

A. I base this on my 32 year experience in this industry which includes the cost analysis for various services as well as significant components of the underlying network. The current telephone network is the result of years and years of evolution. Many services rely on other services in order to be viable. Without a basic platform of services and a way to deliver them, even the simplest service requires extensive infrastructure and this drives up the stand-alone cost. Call waiting, for example, requires a switch, or central processor that must be able to access each and every customer's line so tones or clicks can be delivered directly to the customer. Without the basic network infrastructure, such services would be very expensive to offer by themselves.

¹ Page 3, Line 9, Vanicek Direct Testimony
01-424260.01

IV. RECOMMENDATION

Q. LACKING PROOF, ONE WAY OR THE OTHER, ON WHETHER IMPLICIT SUBSIDIES EXIST IN CURRENT SWITCHED ACCESS RATES, WHAT DO YOU RECOMMEND THE COMMISSION DO IN THIS DOCKET?

A. I recommend that the Commission looks at Qwest's proposal as a matter of public policy. Lacking empirical proof of the existence or amount of subsidies should not deter this Commission from making policy decisions that have far-reaching benefits to the industry and ultimately to customers. It is known that there is historical support for the assumption of policy driven switched access rates that are currently higher than would be expected in today's market. If previous public policies surrounding switched access pricing had not occurred, Qwest would price intrastate switched access equal to interstate switched access rates. No marketing forces exist to keep intrastate rates higher than interstate rates. Public policy has created this situation and that policy was correct in its time. But past policy has created at least a functioning surrogate for implicit subsidies, if not calculable subsidies. It is time for past policies to stop keeping switched access rates higher than they should be. Subsidy support, whether real by economic definition or a policy generated surrogate, should be eliminated or at least reduced because it threatens more important long-term goals. This intended implicit support that exists in current switched access rates can be addressed by this Commission and this support can be shifted away from current switched access revenues. The Commission should keep in mind the broader policy issues such as promoting efficient rate structures, reducing arbitrage , and encouraging cost effective investment.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes it does.

Dated this 12th day of July, 2002.

QWEST CORPORATION

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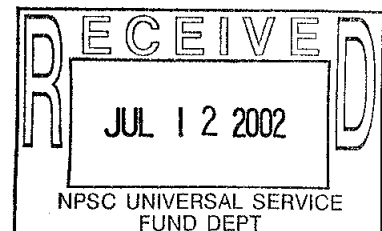
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